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International Accounting Standards Board
7 Westferry Circus
Canary Wharf
London E14 4HD
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Dear Board Members,

RESPONSE TO REQUEST FOR INFORMATION:
POST-IMPLEMENTATION REVIEW – IFRS 9 *FINANCIAL INSTRUMENTS*: CLASSIFICATION AND MEASUREMENT ("RFI")

ISCA welcome and support IASB's initiative in subjecting various IFRSs to Post-Implementation Reviews (PIRs) and subsequently improving the IFRSs in response to feedback gathered during the PIRs.

For this PIR, ISCA have sought views from its members through a two-month public consultation and from the ISCA Financial Reporting Committee which comprises experienced technical professionals from audit firms, preparers of financial statements and other stakeholders.

IFRS 9 provides a principle-based approach to the classification and measurement of financial assets where measurement is aligned with the contractual cash flow characteristics of the assets and the way the entity manages them. However, the classification and measurement requirements appear to be overly complex for most entities with straightforward financial assets which resulted in undue and excessive efforts in the application of these requirements. In addition, the strict application of these requirements may result in misalignment in the measurement of the financial assets with how they are managed in practice.

Our detailed comments to selected specific questions in the RFI are set out below.

Question 1—Classification and measurement

1. Do the classification and measurement requirements in IFRS 9:
(a) enable an entity to align the measurement of financial assets with the cash flow characteristics of the assets and how the entity expects to manage them? Why or why not?

(b) result in an entity providing useful information to the users of the financial statements about the amount, timing and uncertainty of future cash flows? Why or why not?

Please provide information about the effects of the classification and measurement changes introduced by IFRS 9, including the ongoing costs and benefits in preparing, auditing, enforcing or using information about financial instruments. This question aims to help the Board understand respondents' overall views and experiences relating to the IFRS 9 classification and measurement requirements.

We are of the view that the combination of the contractual cash flow characteristics of the financial assets together with the assessment of the entity's business model for managing the financial assets, has generally provided an appropriate basis to align the measurement of financial instruments with how they are managed by the entity.

However, we are concerned that there may be cases where the strict application of the requirements will result in a misalignment in the measurement of the asset as compared to how the entity manages the asset in practice. For instance, if the business model of the asset is to "hold to collect" cash flows and the asset generates mainly payments of principal and interest on the principal amount outstanding, but has immaterial components of other contractual cash flows unrelated to a basic lending arrangement, the asset would have failed the contractual cash flow characteristics test (i.e. solely payments of principal and interest (SPPI)) and is required to be measured at fair value. This is commonly seen in loan books of financial institutions where the entity manages these loans as "hold to collect" and hence, they should be more appropriately measured at amortised cost. However, as they contain immaterial non-SPPI cash flows, they will need to be measured at fair value under IFRS 9. The estimation of fair value for such loans can be challenging and judgemental as they are not quoted or marketable. Correspondingly, the disclosures of these fair values would have limited usefulness or relevance to users of the financial statements.

In view of the above, we urge the Board to consider prioritising or assigning more weightage to the entity's business model for managing the financial asset while asset features such as contractual cash flow characteristics should be secondary considerations to the business model. This will allow entities to better align the classification and measurement of financial assets with their business models in practice.

On the effects of changes introduced by IFRS 9, the costs incurred by preparers were generally higher in the initial year of implementation. One key area would be the preparatory work required for the review of existing financial contracts, and update of processes/controls and systems for the measurement of these instruments. Costs were also incurred in the training of relevant personnel, such as finance staff, for them to gain knowledge of and understand IFRS 9

requirements. Another area would be with respect to audit fees where auditors were involved in the review of management's assessment of existing contracts and processes/systems. However, after initial implementation, the recurring costs were not significantly greater than those for classification and measurement under IAS 39. The main increase in cost would be for the impairment phase of financial assets as the expected credit loss model was a significant change in approach from the previous incurred loss model.

Question 2—Business model for managing financial assets

(a) Is the business model assessment working as the Board intended? Why or why not?

Please explain whether requiring entities to classify and measure financial assets based on the business model assessment achieves the Board's objective of entities providing users of financial statements with useful information about how an entity manages its financial assets to generate cash flows.

(b) Can the business model assessment be applied consistently? Why or why not?

Please explain whether the distinction between the different business models in IFRS 9 is clear and whether the application guidance on the evidence an entity considers in determining the business model is sufficient.

If diversity in practice exists, please explain how pervasive the diversity is and its effect on entities' financial statements.

(c) Are there any unexpected effects arising from the business model assessment? How significant are these effects?

Please explain the costs and benefits of the business model assessment, considering any financial reporting or operational effects for preparers of financial statements, users of financial statements, auditors or regulators.

In responding to (a)–(c), please include information about **reclassification** of financial assets (see Spotlight 2).

The business model assessment generally works reasonably well in practice, except for the reclassification of financial assets. IFRS 9 paragraph B4.4.1 states that an entity can reclassify financial assets if it changes its business model, and such changes to business model are expected to be very infrequent and must be significant to the operations and demonstrable to external parties. This has resulted in the accounting of financial assets being not reflective of the current business model, especially during recent periods of volatility in the macro environment. For example, a "hold to collect" business model may have subsequent sales and the assets are

being managed for sale subsequently. Such changes might not be considered as significant to the operations and/or not demonstrable to external parties. Correspondingly, this does not qualify as a change in business model. This is also the case when management has initially intended for the business model to be “hold to sell” but is unable to achieve that. An example would be the portion of a syndicated loan that a bank has intended to sell down but cannot do so. If the business model was determined to be “hold to sell” at inception, despite later being changed to “hold to collect”, the loan would still have to continue to be measured at Fair Value through Profit or Loss (FVPL). Therefore, a practical expedient, such as allowing a limited timeframe prior to determining the final hold portion, could be used as a better reflection of the actual business model upon realisation.

Question 3—Contractual cash flow characteristics

(a) Is the cash flow characteristics assessment working as the Board intended? Why or why not?

Please explain whether requiring entities to classify and measure a financial asset considering the asset’s cash flow characteristics achieves the Board’s objective of entities providing users of financial statements with useful information about the amount, timing and uncertainty of future cash flows. If, in your view, useful information could be provided about a financial asset with cash flows that are not SPPI applying IFRS 9 (that is, an asset that is required to be measured at fair value through profit or loss applying IFRS 9) by applying a different measurement approach (that is, using amortised cost or fair value through OCI) please explain:

(i) why the asset is required to be measured at fair value through profit or loss (that is, why, applying IFRS 9, the entity concludes that the asset has cash flows that are not SPPI).

(ii) which measurement approach you think could provide useful information about the asset and why, including an explanation of how that approach would apply. For example, please explain how you would apply the amortised cost measurement requirements to the asset (in particular, if cash flows are subject to variability other than credit risk).

(See Section 7 for more questions about applying the effective interest method.)

(b) Can the cash flow characteristics assessment be applied consistently? Why or why not?

Please explain whether the requirements are clear and comprehensive enough to enable the assessment to be applied in a consistent manner to all financial assets within the scope of IFRS 9 (including financial assets with new product features such as sustainability-linked features). If diversity in practice exists, please explain how pervasive the diversity is and its effect on entities’ financial statements.

(c) Are there any unexpected effects arising from the cash flow characteristics assessment? How significant are these effects?

Please explain the costs and benefits of the contractual cash flow assessment, considering any financial reporting effects or operational effects for preparers of financial statements, users of financial statements, auditors or regulators. In responding to (a)–(c), please include information about financial instruments with sustainability-linked features (see Spotlight 3.1) and contractually linked instruments (see Spotlight 3.2).

We are of the view that the requirements for contractual cash flows may not be very well defined, resulting in inconsistencies in practice and application challenges.

IFRS 9 paragraph B4.1.18 states that a contractual cash flow characteristic does not affect the classification of the financial asset if it could have only a de minimis effect on the contractual cash flows of the financial asset. In addition, if a contractual cash flow characteristic could have an effect on the contractual cash flows that is more than de minimis (either in a single reporting period or cumulatively) but that cash flow characteristic is not genuine, it does not affect the classification of a financial asset. However, the terms “de minimis” and “genuine” are not defined in IFRS 9 or any other IFRS Standards. This has resulted in diversity and inconsistency in practice where judgement is required and different thresholds have been adopted by entities. This is especially so for financial instruments with sustainability features (e.g. contractual terms linked to ESG targets such as compliance with emissions and waste regulation standards) where there could be variation in contractual cash flows. Therefore, more guidance would be useful to promote consistency in practice.

Another point is that for financial assets that fail the SPPI test and are in a “hold to collect” business model, Fair Value through Other Comprehensive Income (FVOCI) may provide more useful information than FVPL. Providing an option to elect FVOCI (where any fair value changes are only recognised in the profit or loss upon realisation of these assets) instead of FVPL would provide information about the fair value recorded in balance sheet relating to the financial asset, and any fair value realisation that occurs would only be reflected in the profit or loss by recycling from other comprehensive income. This will be more aligned with the “hold to collect” business model.

Question 7—Amortised cost and the effective interest method

(a) Is the effective interest method working as the Board intended? Why or why not?

Please explain whether applying the requirements results in useful information for users of financial statements about the amount, timing and uncertainty of future cash flows of the financial instruments that are measured applying the effective interest method.

(b) Can the effective interest method be applied consistently? Why or why not? Please explain the types of changes in contractual cash flows for which entities apply paragraph B5.4.5 of IFRS 9 or paragraph B5.4.6 of IFRS 9 (the 'catch-up adjustment') and whether there is diversity in practice in determining when those paragraphs apply.

Please also explain the line item in profit or loss in which the catch-up adjustments are presented and how significant these adjustments typically are If diversity in practice exists, please explain how pervasive the diversity is and its effect on entities' financial statements. In responding to questions (a)–(b), please include information about interest rates subject to conditions and estimating future cash flows (see Spotlight 7).

We are of the view that the application of the effective interest rate (EIR) method appears to be excessive for financial instruments for which the interest computed using the straight-line method does not differ significantly from that computed using EIR method. This has resulted in entities commonly applying the straight-line method in practice and having to justify that there are no material differences between using the EIR method or straight-line method. Hence, the EIR method is not applied consistently. We suggest the Board to consider allowing a practical expedient to be applied for the amortisation of interest using the straight-line method for financial instruments for which there are no material differences from the use of the EIR or straight-line method. This will obviate the need for preparers to explain every year that there are no differences.

In addition, we note that changes in estimates under amortised cost accounting are not treated consistently with changes in estimates of other items such as changes in useful lives of fixed assets. Such changes are usually due to catch-up adjustments being made and these are required to be considered as possible modifications of the instruments instead of as a prospective change. Hence, there is a lack of clarity on the rationale for the difference in treatment.

Should you require any further clarification, please feel free to contact Ms Felicia Tay at felicia.tay@isca.org.sg or Ms Jezz Chew at jezz.chew@isca.org.sg.

Yours faithfully,

Mr Wai Geat, KANG
Director
Professional Standards Division